IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 155 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE A.R.DAVE
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

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S.DAVE & CO.

Versus

C.I.T.

Appearance:

1. INCOME TAX REFERENCE No. 155 of 1988
MR JP SHAH for Petitioner No. 1
MR MANISH R BHATT for Respondent No. 1

CORAM : MR.JUSTICE A.R.DAVE
and
MR.JUSTICE D.A.MEHTA

Date of decision: 05/09/2002

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

The Income Tax Appellate Tribunal, Bench 'B' has referred the following question for the opinion of this Court under Section 256 (1) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act')

"Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the income of M/s. Dave Transport Co. was taxable in the hands of the assessee firm?"

2. The assessment year is 1976-77 and the relevant accounting period being S.Y. 2031. The assessee-applicant is a partnership duly registered under the provisions of the Act and the Partnership Act. The business of the assessee firm is to act as consignee distributor/consignee agent of Tata Chemicals Limited. The Income-tax Officer came to the conclusion that during the year under consideration, a new firm by the name of Dave Transport Company (new firm) had been floated for the purpose of diverting business and income of the assessee firm. It was further held by the Income Tax Officer that new firm was not a genuine firm and for this purpose the constitution of new firm, the activities carried on by the new firm, the inter-se relations between the partners of new firm and the assessee firm, the financial position, namely, contribution of capital by the partners of the new firm etc. were factors which were taken into consideration by the Income-tax Officer. Thus, according to the Income-tax Officer, all the receipts of the new firm were from the assessee firm and, therefore, the business in the name of the new firm was a part and parcel of the business of the assessee firm. On a reference under Section 144B of the Act, the Inspecting Assistant Commissioner agreed with the findings recorded by the Income Tax Officer, but also invoked provision of Section 40A(2) of the Act in support of the contention that the business carried on by the new firm was not an independent business. Registration to the new firm was also denied by the Income Tax Officer.

3. The assessee firm and the new firm, both, went in appeal before the Commissioner (Appeals) and in respect of registration, the Commissioner (Appeals) accepted the claim of the new firm holding that it was a genuine firm, duly constituted under a valid partnership and was entitled to registration under relevant provisions of the Act. In the appeal filed by the assessee firm, the Commissioner (Appeals) held that there was no diversion

of any business by the assessee firm nor was there any device to reduce the tax liability of the assessee firm. However, the Commissioner (Appeals) upheld the applicability of the provision of Section 40A(2) of the Act and held that 10% of the net profits earned by the new firm on carting done by the new firm for the assessee firm had to be added as income of the assessee firm because payment of carting expenses to the said extent was excessive and unreasonable.

4. The revenue, being aggrieved by the aforesaid orders of the Commissioner (Appeals), preferred appeals before the Tribunal. The Tribunal upheld the findings of the Commissioner (Appeals) regarding genuineness of the new firm and granting of registration to the new firm. Thus, in substance, the revenue's appeal against the new firm was dismissed. However, the revenue's appeal in case of the assessee firm came to be allowed by holding that the whole income of the new firm was on account of diversion of income by the assessee firm. It is the aforesaid order which is challenged by the assessee firm by raising the question reproduced hereinbefore.

5. Mr. J.P. Shah, learned advocate appearing on behalf of the applicant-assessee stated that the assessee's business was governed by the terms of the agreement that the assessee had entered into with Tata Chemicals Limited, while the business carried on by the new firm was governed by a separate independent agreement entered into by the new firm with the assessee firm. It was further submitted by Mr. J.P. Shah that the constitution of the new firm and the assessee firm were entirely different and this aspect had been accepted by both the appellate authorities while holding that the new firm was genuine and was entitled to registration. Mr. J.P. Shah further submitted that as per the terms of the agreement of the assessee with Tata Chemicals Limited, the rate for transport of various items had been specified and on the basis of the same, the assessee firm was entitled to reimbursement as per terms of the agreement; that for the purpose of transporting various goods, the assessee firm had engaged one Patni transport. The assessee was finding it difficult to supervise timely delivery of goods to the customers which was an essential requirement of the agreement entered into by the assessee with Tata Chemicals Limited. It was in this context that the assessee firm decided to entrust the job of carting the goods to the new firm. It was also pointed out by Mr. J.P. Shah that a partner of the new firm had been examined by the Assessing Officer and in the statement recorded by the Income Tax Officer the nature and the

mode of the business carried on by the new firm had been specifically stated by the partner. Mr. J.P. Shah summarised his contention stating that the two firms exist independently in their own right; that the income had been earned by the two firms out of independent business carried on by them, and the profits earned had been enjoyed by the partners of the respective firms. Thus, without there being anything more, it was not possible to club the incomes of the two firms taking into consideration the fact of registration having been granted by treating the new firm as genuine and accepting that the business was carried on independently. It was also submitted that when the I.A.C. invoked provisions of Section 40A(2) of the Act, it was established that there was an independent transaction and the expenses incurred was otherwise allowable, but only reasonableness thereof had to be determined. In support of the various submissions made, Mr. Shah placed reliance on the following decisions;

1. MADURA KNITTING COMPANY Vs. COMMISSIONER OF INCOME-TAX AND EXCESS PROFITS TAX, MADRAS reported in (1956) 30 I.T.R. 764 (Madras).

2. JUGGILAL KAMLAPAT Vs. COMMISSIONER OF INCOME-TAX, WEST BENGAL reported in (1963) 53 I.T.R. 351(Calcutta)

3. COMMISSIONER OF INCOME-TAX, WEST BENGAL Vs. JUGGILAL KAMALAPAT reported in (1966)63 I.T.R. 292 (S.C.).

6. Mr. B.B. Naik, learned Standing Counsel appearing on behalf of the respondent revenue submitted that the basic postulate on which the entire assessment was framed was that income of the assessee firm was diverted to the new firm. For this purpose, he relied upon the following observation recorded in the assessment order.

"In this manner, profits that would accrue to the assessee are shown as accrued to another firm."

Accordingly, it was contended that the profits which were to accrue to the assessee firm, in case the assessee firm had not entered into an agreement with the new firm, are now shown to have accrued to the new firm and accordingly income which was liable to tax in the hands of the assessee firm stood diverted to the new firm. The findings recorded by the Tribunal in paragraphs 8 and 8.1

of its order were read out in extenso and it was emphasised that after taking into consideration the terms of agreement entered into by the assessee firm with Tata Chemicals Limited, the Tribunal had recorded a finding of fact to the effect that income shown by the new firm was only from the receipts of the assessee firm on account of carting charges. It was further submitted that during the year under consideration the new firm did not have sufficient number of vehicles for the purpose of undertaking the job of carting and as found by the Tribunal, the vehicles were purchased only after the new firm had come into existence and had already commenced business. It was further submitted that the revenue was not required to challenge the finding of the Commissioner (Appeals) in relation to applicability or otherwise of the provisions of Section 40A(2) of the Act as the department was challenging the principal finding and the entire case of the department was that there was diversion of income from the assessee firm to the new firm. As an alternative contention it was submitted that in case the Court feels that the Tribunal has recorded contrary findings, the matter should be remanded to the Tribunal so as to enable the Tribunal to resolve the controversy taking into consideration the factual matrix and the evidence on record.

7. The Tribunal in the impugned order dated 28th October, 1987 has framed the following five issues which, according to the Tribunal, arose for its consideration.

(i) Whether the business of the new firm could be considered as part and parcel of the business of the old firm, that is to say, whether the new firm was only an extention of the old firm so as to justify the clubbing of the income.

(ii) Whether the income shown by the new firm could be considered as the income diverted by the old firm.

(iii) Whether finding of the commissioner (Appeals) on the basis of provisions contained in Section 40A(2) that only 10% of the income of the new firm is required to be added in the income of the old firm, any way helps the assessee's case.

(iv) Whether the new firm is required to be treated as genuine for the purpose of grant of registration.

(v) If registration is granted to the new firm yet whether income of the new firm can be added to

the income of the old firm.

7.1 In relation to the first issue, it has been held by the Tribunal that the new firm could not be treated as an extension of the assessee firm nor could the business of the new firm be considered as part and parcel of the business of the assessee firm and hence clubbing of income on that count could not be justified.

7.2 In relation to issue no. 2, the Tribunal has held that the income shown by the new firm could be considered as the income diverted by the assessee firm. As this is the main point on which the entire controversy requires to be resolved, we shall deal with this aspect of the matter i.e., whether the said findings is correct in law or not at length a little later.

7.3 In relation to issue no. 3, the Tribunal observed that the finding of the Commissioner (Appeals) that provisions of Section 40A(2) of the Act were applicable to the facts of the case and only 10% of the income of the new firm was required to be added in the income of the assessee firm did not help the assessee's case in any manner.

7.4 In relation to issue no. 4, the Tribunal has held that the new firm is required to be treated as genuine for the purpose of grant of registration.

7.5 In relation to issue no. 5, the Tribunal has held that even where registration is granted to the new firm income of the new firm could be added to the income of the assessee firm.

8. The Tribunal has recorded two sets of findings, which are contrary to each other; namely if findings of set A are taken to be correct, the findings of set B cannot prevail and vice versa.

9. The findings in the first set which are primarily in favour of the assessee are as under;

(a) There is no dispute regarding the formation of the new partnership firm being valid in law.

(b) The business of the new firm is not the same as that of the old firm.

(c) Both the partnership firms are distinct as clarified by the intention of the partners of the new firm as well as the assessee firm and also

the constitution by which both the firms are formed.

(d) The new firm is registered with various authorities as required under various laws and rules.

(e) The profits earned by the new firm have been apportioned amongst the partners in specified shares and there is no finding that the profits were not enjoyed by the partners themselves.

(f) Taking into consideration subsequent events also it was quite clear that the intention of the partners in forming the partnership was real and the new firm had built up assets of the firm.

(g) Some of the factors like a few of the partners not having contributed any capital, or some of the partners not having say in the management of the firm, was not fatal to the claim for registration of the new firm. In fact the deed of partnership of the new firm specifically mentions as to who are the partners under obligation to bring capital required for the business and who are the partners who would be in charge of the working of the firm.

(h) The factors like there being no independent office premises or furniture or telephone would not adversely affect the claim regarding registration as long as there was material to hold that the partnership was distinct and separate.

(i) That it was not at all necessary that all the partners must be active partners and all of them must have full knowledge about the affairs of the business.

(j) It was an undisputed fact that partners of the new firm had been separately assessed by the Income-tax Officer, before the order was passed denying registration to the new firm.

(k) The finding of the Assessing Officer that the business of the assessee firm in respect of carting had been diverted to the new firm and so that was part and parcel of the old firm was incorrect.

(l) The business intended to be undertaken and undertaken by the new firm was a new business altogether.

10. As against this, the second set of findings recorded by the Tribunal which are against the assessee are as under:

(a) As per terms of the agreement between the assessee firm and Tata Chemicals Limited, the assessee firm was required to look after the transportation of goods consigned for the purpose of storing in the warehouse as also distributing the same to various consumers.

(b) The assessee firm was entitled to reimbursement of such expenses as per terms of agreement and there used to be resultant surplus in hands of the assessee firm.

(c) After the agreement was entered into by the assessee firm, with the new firm the carting job was undertaken by the same outside agency namely Shri Bansilal Patni, but the same was now on behalf of the new firm. Therefore, the difference between carting charges paid by the assessee firm to the new firm and carting charges paid by the new firm to the outside agency would constitute excess of carting charges paid by the assessee firm to the new firm as taxable receipts in the hands of the assessee firm

(d) That during the year under consideration the new firm did not have requisite paraphernalia so as to undertake the job of transportation and carting fully and that is why the new firm got the work of carting done through the outside agency.

(e) That, though the agreement between the assessee firm and the new firm was executed on 1st January, 1975, the new partnership firm came into existence only on 2nd January, 1975.

(f) The issue regarding registration being granted to the new firm became academic because the Tribunal was holding that the whole income of the new firm was on account of diversion of income by the assessee firm.

(g) That the grant of registration by treating the

new firm as genuine was altogether separate and distinct form the issue regarding the income required to be added, either in whole or in part, in the hands of the assessee firm.

(h) The income really accrued to the old firm but it having been applied subsequently for the benefit of the new firm, was taxable in hands of the assessee firm.

11. What should be the approach in such circumstances has been succinctly laid down by the Apex Court in the case of LALCHAND BHAGAT AMBICA RAM Vs. COMMISSIONER OF INCOME-TAX, (1959)37 I.T.R.288, in the following words;

"When a court of fact arrives at its decision by considering material which is irrelevant to the enquiry, or acts on material, partly relevant and partly irrelevant, and it is impossible to say to what extent the mind of the court was affected by the irrelevant material used by it in arriving at its decision, a question of law arises: whether the finding of the court of fact is not vitiated by reason of its having relied upon conjectures, surmises and suspicions not supported by any evidence on record or partly upon evidence and partly upon inadmissible material.

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The Income-tax Appellate Tribunal is a fact finding tribunal and if it arrives at its own conclusions of fact after due consideration of the evidence before it the Court will not interfere. It is necessary, however, that every fact for and against the assessee must have been considered with due care and the Tribunal must have given its finding in a manner which would clearly indicate what were the questions which arose for determination, what was the evidence pro and contra in regard to each one of them and what were the findings reached on the evidence before it. The conclusions reached by the Tribunal should not be coloured by any irrelevant considerations or matters of prejudice and if there are any circumstances which required to be explained by the assessee, the assessee should be given an opportunity of doing so. On no account whatever should the Tribunal base its findings on suspicions, conjectures or surmises, nor should it act on no evidence at all or on improper

rejection of material and relevant evidence or partly on evidence and partly on suspicions, conjectures and surmises, and if it does anything of the sort, its findings even though on questions of fact will be liable to be set aside by the Court."

12. The Tribunal, having held that the new firm was genuine, was validly constituted in law, was entitled to registration, could not have thereafter come to the conclusion that the income which accrued to the new firm stood diverted to the assessee firm. In our opinion, the Tribunal singularly failed to appreciate the correct position of law in this regard.

13. Section 2(23) of the Act defines the terms "firm","partner" and "partnership" as follows;

"(23)"firm", "partner" and "partnership" have the meanings respectively assigned to them in the Indian Partnership Act, 1932 (9 of 1932); but the expression "partner" shall also include any person who, being a minor, has been admitted to the benefits of partnership"

14. Therefore, this definition takes us to the provisions of Section 4 of the Indian Partnership Act, 1932, which reads as under:

"Partnership" is the relation between person who have agreed to share the profit of a business carried on by all or any of them acting for all.

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm" and the name under which their business is carried on is called the "firm name"."

On a bare reading of the aforesaid Section, it is clear that (1) there must be an agreement entered into by all the partners concerned; (2) the agreement must be to share profits of business; and (3) such business must be carried on by all or any one of the persons concerned, acting for all.

15. Once the Tribunal had arrived at this finding namely, that the partnership was genuine and that the business intended to be undertaken and undertaken was by a new firm altogether and further that the business of the assessee firm in respect of carting was not diverted

to the new firm, it could not have thereafter held that the income of the assessee firm had been diverted to the new firm. Business, as such, is primarily a source of income. Once the Tribunal had found, as a matter of fact, that the source itself was not transferred or diverted but a new firm had intended to undertake and had undertaken a new business altogether, there was no occasion for the Tribunal to hold that income of the assessee firm had been diverted. The source of the new firm being new business as found by the Tribunal, the income emanating from such a source had to accrue to the new firm and was liable to tax in hands of the new firm and could not be treated as income which was diverted from the assessee firm

16. In these circumstances, the findings recorded by the Tribunal in the second set are, to say the least perverse, against established principles of law and not borne out from the records as could be seen from the other set of findings recorded by the Tribunal. Even if for the sake of argument, it is accepted for a moment, that the Tribunal could have recorded these findings on the material and evidence before it then the two sets of findings are so contra indicative of each other that they cannot co-exist together and one set would destroy the other. As held by the Apex Court in the case of LALCHAND BHAGAT AMBICA RAM Vs. COMMISSIONER OF INCOME-TAX (Supra), once the fact finding tribunal has taken into consideration, factors which are partly relevant or partly irrelevant, it would not be possible for the Court to say to what extent the mind of the Tribunal was affected by such consideration and the entire findings would stand vitiated. In these circumstances, the Court would be required to set aside such findings altogether and arrive at its own conclusion.

17. Applying the aforesaid principles, it is apparent that a partnership duly recognised in law had come into existence in the name of M/s. Dave Transport Company after fulfilling all the necessary conditions in law. That the partners had come together to share profits of a business and it is not possible to accept the contention of the revenue that it was the same business which was carried on by the assessee firm that was being conducted by the new firm in light of the findings regarding genuineness of the new firm. In fact it is not possible to envisage existence of a partnership without there being any business. The Tribunal lost sight of the fact that the agreement between the assessee firm and the new firm has neither been doubted nor challenged by anyone. There is nothing in the agreement between the assessee

and Tata Chemicals Limited which prohibits the assessee from hiring outside agency for the purpose of transportation and delivery of goods; in fact the assessee firm had been obtaining the services of Patni Transport. Now, the only thing that has changed is, the assessee firm has hired the new firm instead of Patni Transport. If this is clear, and in our opinion it is so, there is no occasion to hold that the income earned by the new firm was diverted by the assessee firm. When the same expenditure was treated as separate income in the name of Patni Transport nothing has been brought on record to show that it has changed the character insofar as the new firm is concerned. The Tribunal on the one hand states that the difference between carting charges paid by the assessee firm to the new firm and the carting charges paid by the new firm to the outside agency would constitute excess of carting charges paid by the assessee firm to the new firm as taxable receipts in the hands of the assessee firm and in the same breath states that income really accrued to the old firm but was applied subsequently for the benefit of the new firm. Again the Tribunal at another place stated that the whole income of the new firm was on account of diversion of income by the assessee firm. In the event, the whole income was diverted by the assessee, there was no occasion for the Tribunal to state that only difference between carting charges paid by the assessee to the new firm and by the new firm to the outside agency was the taxable receipt in hands of the assessee firm. Similarly, if there was application of income by the assessee firm the question of taxing the difference cannot arise.

18. When the two sets of findings as extracted hereinbefore are placed in juxtaposition, it is apparent that the Tribunal has made statements which are contrary to each other on the same set of facts. Thus, the approach of the Tribunal is bad in law with special reference to the principle of law laid down in the decision of this Court in the case of BANYAN AND BERRY Vs. COMMISSIONER OF INCOME-TAX (1996) 222 I.T.R. 831. The Court has specifically stated that, (the case before the Court was in relation to dissolution deed being a device while in the present case, it is an accepted position that there is no device), not all legitimate acts of a tax payer which he undertakes in the ordinary course of his business and is entitled under law to do, can be branded as being of questionable character even on the anvil of the Apex Court's decision in the case of MCDOWELL AND COM. LTD. Vs. C.T.O (1985) 154 I.T.R. 148. It is stated "while planning adopted as device to avoid tax had been deprecated, the principle cannot be

read as laying down the law that a person is to arrange his affairs so as to attract maximum tax liability, and every act which results in tax reduction, exemption of tax or not attracting tax authorised by law is to be treated as device of tax avoidance"

18.1 In the present case at the cost of repetition, it requires to be stated that nobody has alleged adoption of a device for tax avoidance. In such circumstances, merely because the new firm has undertaken a business which was carried on by the assessee firm through the services of Patni Transport, it cannot be held that the income has been diverted by the assessee firm in favour of the new firm.

19. In light of the fact that M/s Dave Transport Company was an independent entity which carried on a new and a separate business, separate from the business of the assessee firm, it is not possible to uphold the findings of the Tribunal that income of M/s. Dave Transport Company was taxable in the hands of the assessee firm. The question referred to us is, therefore, answered in the negative, that is in favour of the assessee and against the revenue.

The reference stands disposed of accordingly. There shall be no order as to costs.

(A.R. DAVE,J.)

(D.A. MEHTA,J.)

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